Testimony before the United States Congress on behalf of the

Testimony of

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before the

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on the subject of

Limiting Lawsuit Abuse

Thank you, Mr. Chairman and distinguished Committee members for inviting me to provide testimony regarding the tremendous negative effects lawsuits, and particularly the fear of lawsuits, are having on the millions of small-business owners in America today. My name is Karen Harned and I serve as Executive Director of the National Federation of Independent Business (NFIB) Legal Foundation, the legal arm of NFIB. The NFIB Legal Foundation is charged with providing a voice in the courts for small-business owners across the nation.

NFIB has 600,000 members, and is represented in each of the fifty states. NFIB represents small employers who typically have about five employees and report gross sales of $300,000 - $500,000 per year. NFIB's average member nets $40,000 - $60,000 annually. NFIB members represent an important segment of the business community – a segment with challenges and opportunities that distinguish them from publicly traded corporations.

Although federal policy makers often view the business community as a monolithic enterprise, it is not. NFIB members, and hundreds of thousands of small businesses across the country, do not have human resource specialists, compliance officers, or attorneys on staff. These businesses cannot pass on to consumers the costs from taxes, regulations, and liability insurance without suffering losses.

Being a small-business owner means, more times than not, you are responsible for everything – taking out the garbage, ordering inventory, hiring employees, dealing with the mandates imposed upon your business by the federal, state and local governments, and responding to threatened or actual lawsuits. For small-business owners, even the threat of a lawsuit can mean significant time away from their business. Time that could be better spent growing their enterprise and employing more people.

The NFIB Legal Foundation applauds the Committee for holding this hearing in order to focus on the ever-growing problem of frivolous lawsuits.

Frivolous Lawsuits Create a Climate of Fear for America's Small Businesses

Small-business owners rank the "Cost and Availability of Liability Insurance" as the second most important problem facing small-business owners today, according to a survey just released by the NFIB Research Foundation.[1] The only problem ranked higher is rising health-care costs.

[1] "Small Business Problems and Priorities," Bruce D. Phillips, NFIB Research Foundation. (June 2004).

This number two ranking represents a significant increase from the thirteenth position it held in the 2000 "Small Business Problems and Priorities" survey.[2] More than 30% of businesses today regard the "Cost and Availability of Liability Insurance" as a critical issue, compared to 11% in 2000 – a threefold increase.[3] With a dramatic rise in the cost of lawsuits[4], it is not surprising that many small-business owners 'fear' getting sued, even if a suit is not filed."[5] That possibility – the fear of lawsuits – is supported by a recent NFIB Research Foundation National Small Business Poll, which found that about half of small-business owners surveyed either were "very concerned" or "somewhat concerned" about the possibility of being sued.[6] The primary reasons small-business owners fear lawsuits are: (1) their industry is vulnerable to suits; (2) they are often dragged into suits in which they have little or no responsibility; and (3) suits occur frequently.[7]

The bottom line is that the escalating numbers of lawsuits (threatened or filed) are having a negative impact on small-business owners. For two years, as Executive Director of NFIB's Legal Foundation, I have heard story after story of small-business owners spending countless hours and sometimes significant sums of money to settle, defend, or work to prevent a lawsuit.

For the small-business owner with five employees or less, the problem is the $5,000 and $10,000 settlements, not the million dollar verdicts. When you consider that many of these small businesses only net $40,000 - $60,000 a year, $5,000 paid to settle a case immediately eliminates about 10% of a business' annual profit. Small-business owners also are troubled by the fact that they often are forced to settle a case at the urging of their insurer. In most cases, if there is any dispute of fact, the insurer will perform a cost-benefit analysis. If the case can be settled for $5,000 the insurer is likely to agree to the settlement because generally it is less expensive than litigating, even if the small-business owner would ultimately prevail in the suit.

Once the suit is settled, the small-business owner must pay with higher business insurance premiums. Typically, it is the fact that the small-business owner settled a case, for any amount, which drives insurance rates up; it does not matter if the business owner was ultimately held liable after a trial. Not surprisingly, a recent NFIB Research Foundation National Small Business Poll shows that 64% of small employers believe that

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2 "Small Business Problems and Priorities," William J. Dennis, Jr., NFIB Education Foundation (May 2000).

3 "Small Business Problems and Priorities," (June 2004), at 7.

4 "U.S. Tort Costs: 2003 Update, Trends and Findings on the Costs of the U.S. Tort System," Tillinghast-Towers Perrin, 2003.

5 *Id*. at 7-8.

6 NFIB National Small Business Poll, "Liability," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 2 (2002).

7 *Id*. at 1.

the biggest problem with business insurance today is cost.[8] Many small-business owners understand this dynamic, and as a result, will settle claims without notifying their insurance carriers.

In addition to the financial costs of settling a case are the psychological costs. Small-business owners threatened with lawsuits often would prefer to fight in order to prove their innocence. They do not appreciate the negative image that a settlement bestows on them or on their business.

The Impact of Frivolous Lawsuits on Small Business

We would all like to think that attorneys comply with the highest ethical standards; unfortunately, that is not always the case. In my experience, this seems particularly true of plaintiffs' attorneys who bring lower-dollar suits – the type of suits of which small businesses are generally the target. In many instances, a plaintiff's attorney will just take a client at his word, performing little, if any, research regarding the validity of the plaintiff's claim. As a result, small-business owners must take time and resources out of their business to prove they are not liable for whatever "wrong" was theoretically committed. As one small-business owner remarked to me last year, "What happened to the idea that in this country you are innocent until proven guilty?"

Although that mantra refers to a defendant's rights in our criminal justice system, problems with our civil justice system can no longer be ignored. It is incumbent upon the attorney representing a plaintiff to get the facts straight ***before*** sending a threatening letter or filing a lawsuit, not after the letter is sent or the lawsuit is filed. Sadly, due in large part to the ineffectiveness of Rule 11 in its current form, we have a legal system in which many plaintiffs' attorneys waste resources and place a significant drain on the economy by making the small-business owner do the plaintiff's attorney's homework. It often is up to the small-business owner to prove no culpability in cases where a few hours of research, at most, would lead the attorney for the plaintiff to conclude that the lawsuit is unjustified.

Small business is the target of so many of these frivolous suits because trial lawyers understand that a small-business owner is more likely than a large corporation to settle a case rather than litigate. Small-business owners do not have in-house counsels to inform them of their rights, write letters responding to allegations made against them, or provide legal advice. They do not have the resources needed to hire an attorney nor the time to spend away from their business fighting many of these small claim lawsuits. And often they do not have the power to decide whether or not to settle a case – the insurer makes that decision.

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[8] NFIB National Small Business Poll, "Business Insurance," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 7 (2002).

Frivolous Lawsuits Come in Many Shapes and Sizes

Frivolous lawsuits take different forms, and I will highlight those types of suits that have been brought to my attention. I place these suits into four categories – "Pay me now, or I'll see you in court"; "Somebody has to pay, and it might as well be you"; "Let's not let the facts get in our way," and "Yellow Page lawsuits."

"Pay me now, or I'll see you in court."

An increasingly popular tool, which can be quite effective against the small-business owner, is the "demand" letter. In my experience, plaintiffs and their attorneys find "demand" letters particularly attractive when they can file a claim against a small-business owner for violating a state or federal statute. Generally, on behalf of a plaintiff, an attorney will send a one and a half to two-page letter alleging the small business violated a particular statute. The letter is replete with cites to statutes and case law. At some point, the attorney's letter states that the business owner has an "opportunity" to make the whole case go away by paying a settlement fee up front. Timeframes for paying the settlement fee are typically given. In some cases, there may even be an "escalation" clause, which raises the price the business must pay to settle the claim as time passes. So, a business might be able to settle for a mere $2,500 within 15 days, but if it waits 30 days, the settlement price "escalates" to $5,000. At some point, however, a suit is threatened. Legal action is deemed imminent.

An example of such a case was a suit threatened against Custom Tool & Gage, Inc. owned by Carl T. Benda and located in Cleveland, Ohio. The plaintiff in the case ultimately withdrew his complaint one week after threatening legal action against Custom Tool & Gage, Inc. The company's attorney sent a response letter and noted that the plaintiff in the case, James Brown, was neither the owner nor the buying agent for Miller Bearing Company Inc., the business that received the fax. Miller Bearing Company is a regular customer of Custom Tool & Gage, Inc. and had placed five orders with Custom Tool and Gage, Inc. in 2004 alone. James Brown was a truck driver for Miller Bearing Company, and not authorized to file such a lawsuit on behalf of the company. That fact would have taken little time for Mr. Brown's attorney, Joseph Compoli, Jr., to uncover.

Below are excerpts of the "demand" letter sent to Custom Tool & Gage. The letter was accompanied by a signed complaint, which was ready to be filed in the Court of Common Pleas for Portage County, Ohio. I request that a copy of the letter, the complaint, the subsequent correspondence leading to the withdrawal of the suit, and a March 3, 2004 newspaper article discussing the tactics employed by Mr. Joseph Compoli, Jr. in similar "do not fax" suits be admitted into the record.

This office represents the above referenced client. We have been retained to bring a lawsuit against Custom Tool & Gage, Inc., in connection with your transmitting of one unsolicited facsimile ("fax") advertisement to our client….

Kindly be advised that it is a violation of the Telephone Consumer Protection Act (TCPA), Title 47, United States Code, Section 227, to transmit fax advertisements without first obtaining the 'prior express invitation or permission' of the recipient. *See,* 47 U.S.C. 227(a)(4) and 227(b)(1)(C). In addition, Ohio courts have declared that a violation of the TCPA is a[n] [sic] 'unfair or deceptive' act or practice under the Ohio Consumer Sales Practices Act (CSPA), Section 1345.02(A) of the Ohio Revised Code.

We are sending you this letter for the purpose of offering you an opportunity to resolve this matter without the expense of court litigation and attorneys['] [sic] fees. We are authorized to amicably settle this claim for the amount of **$1,700**. This amount represents the sum of $1,500 under the TCPA and $200 under the CSPA for each unsolicited fax advertisement[,] [sic] which was received by our client.

…

We believe that our proposed settlement is very fair and reasonable under the circumstances. We will leave this offer open for fifteen (15) days from the date of this letter.

Recently, in the case of *Nicholson v. Hooters of Augusta*, a court in Georgia awarded over $11.8 million in a class action lawsuit under the TCPA. Also, more recently, in the case of *Gold Seal Termite & Pest Control v. Prime TV LLC*, a court in Indiana has certified a **nationwide class action** against Prime TV for sending unsolicited fax advertisements.

If it becomes necessary for our office to file a lawsuit, we will pursue all legal remedies, including seeking certification of the case as a Class Action under the

> TCPA. This could result in a court order for *you* to pay *$1,500* to each and every person to whom you have sent unsolicited fax advertisements.
>
> If you have an insurance agent or company, please forward this letter to your agent or insurance company. If not, please contact our office directly.[9]

Even though this case was completely baseless, Mr. Benda still was required to spend $882.60 (over half the amount of the settlement costs) to his attorney to draft the letter and avoid payment of the settlement.

"Somebody has to pay, and it might as well be you."

These frivolous suits are the type in which the plaintiff may have been harmed, but is suing the wrong person.

For example, Bob Carnathan, an NFIB member, owns Smith Staple and Supply Co., a small nail and staple fastening business located in Harrisburg, Pennsylvania. Mr. Carnathan's business leases space in a strip mall. After a snowstorm, one of the tenants in the complex was walking across the parking lot when he slipped and fell on the icy pavement injuring his back and head. The medical bills from his injury totaled a little over $3,000. The man sued every tenant in the complex, as well as the landlord and the developer, for $1.75 million. Mr. Carnathan was sued even though he was not at fault because his rent included maintenance on the facilities and grounds.

After two years of endless meetings and conference calls, Mr. Carnathan learned that his business was released from the lawsuit. He says that there is no compensation for the time that he was forced to spend away from his business to fight this unfair lawsuit. Mr. Carnathan firmly believes that "the smaller your business, the more you are impacted when a frivolous lawsuit lands on your doorstep."[10]

Another NFIB member is in the midst of litigation and likely will be dropped from the lawsuit shortly. This member asked that the business' story remain anonymous, so as not to jeopardize dismissal of the lawsuit. The NFIB member, an optometrist, referred a patient who needed cataract surgery to an ophthalmologist. The patient died in pre-op. Although this is a tragic story, the death was not caused by the optometrist's appropriate referral. Despite this fact, the optometrist was named as a defendant in the wrongful death lawsuit filed by the deceased's mother. The litigation has been ongoing

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[9] Letter dated March 11, 2004 from Joseph R. Compoli, Jr., Attorney at Law, to Custom Tool & Gage, Inc.

[10] The NFIB Small Business Growth Agenda for the 108th Congress, at 15.

for two years, and the NFIB member recently completed a lengthy deposition. In addition to time spent preparing for and attending the deposition, this NFIB member has spent many hours completing paperwork related to the suit and meeting with the member's attorney. As a result of the deposition, it appears that the optometrist will be dismissed from the wrongful death lawsuit.

"Let's not let the facts get in our way."

Plaintiffs, and even attorneys sometimes, go to great lengths to stage injuries for prospective lawsuits. These lawsuits pose severe difficulties for small-business owners. In these suits, if the business does not catch the plaintiff in a blatant lie early in the process, the small-business owner must suffer the costs of litigation or settle a fabricated claim.

For example, an NFIB member was threatened (in a "demand" letter) with a lawsuit for an injury that could not have possibly occurred. This roofing company, which requested to remain anonymous, delivered supplies to a convenience store parking lot in preparation for a future roofing job. A customer of the convenience store noticed the materials in the parking lot, and contacted an attorney. The attorney threatened the roofing company with a lawsuit claiming a rock fell from the roof striking the plaintiff and her car's windshield. The roofing company was not working on the project at the time of the alleged accident. Upon notification, the plaintiff's attorney immediately withdrew the threatened legal action. By catching the falsehood early, this company avoided any further threats or litigation.

Some members have not been so lucky. Four former employees of a small family owned restaurant sued the owners for sexual harassment after abruptly quitting. The NFIB members who own the restaurant have requested to remain anonymous. Two months prior to quitting, the four employees consulted an attorney who coached them on how to set up the lawsuit. Sent to work with secret tape recorders, the four employees gathered no useful evidence in the two months prior to quitting. The plaintiffs' attorney filed a complaint with the Equal Employment Opportunity Commission, and the state human rights agency. The restaurant owners went to mandatory mediation, and attended costly hearings and depositions.

Suddenly, one of the plaintiffs decided to withdraw. During depositions the plaintiff had generally denied any allegations raised by the complainants. In a sworn affidavit, the former plaintiff recanted all of her allegations, explained how the complaint filed on her behalf was untrue, and further explained the planning stages for the lawsuit during which she was routinely encouraged to lie by her former coworkers. The plaintiffs' attorney still would not withdraw the case. After $100,000 in defense fees, a second mortgage, and negative press, the defendants settled with the three remaining plaintiffs to avoid bankruptcy and further humiliation.

"Yellow Page Lawsuits"

These lawsuits are more commonly found in class action cases. In these cases, hundreds of defendants are named in a lawsuit, and it is their responsibility to prove that they are not culpable. In many cases, plaintiffs name defendants by using vendor lists or even lists from the Yellow Pages of certain types of businesses (e.g., auto supply stores, drugstores) operating in a particular jurisdiction.

Unfortunately, Tom McCormick, President of American Electrical, Inc. in Richmond, Virginia, knows these tactics all too well. Mr. McCormick's company was named in an asbestos lawsuit. According to Mr. McCormick, attorneys for the plaintiffs simply named as defendants vendors from a generic vendor library. If the lawyers had performed a simple review of the facts, they would have discovered that American Electrical did not yet exist during the period in which the plaintiffs allege the exposure occurred. Furthermore, American Electrical has never sold any products that contain asbestos. Fortunately, Mr. McCormick successfully had American Electrical removed from the defendant list. It still cost Mr. McCormick $8,000 in attorney's fees to resolve this dispute.

A petroleum company, an NFIB member who wishes to remain anonymous, has been sued twice in the past few years. In each lawsuit the plaintiff, suffering from cancer, sued over 100 companies, most listed as John Doe defendants. The product believed to contribute to the cancer was allegedly manufactured by Chevron. The petroleum company merely barreled the product. Yet the liability insurance carriers for each defendant settled the case for $1,500 - $1,800 a piece. By distributing the costs of settling, the plaintiff received a huge payout, while the insurance companies and businesses avoided the large costs of a lawsuit.

"Yellow Page Lawsuits" also provide examples of forum shopping. Hilda Bankston, former owner of Bankston Drugstore in Jefferson County, Mississippi, saw her business named as a defendant in hundreds of Fen-Phen lawsuits brought by plaintiffs against a number of pharmaceutical manufacturers.[11] Ms. Bankston said that Bankston Drugstore was the only drugstore in Jefferson County and, by naming it in these lawsuits, the plaintiffs' attorneys were able to keep these cases in "a place known for its lawsuit-friendly environment."[12]

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[11] Testimony of Ms. Hilda Bankston before the United States Senate Committee on the Judiciary, "Class Action Litigation," (July 31, 2002).

[12] *Id*.

Solutions for Small Business

Surveys, statistics, and stories show that lawsuit abuse is alive and well in the United States, and small businesses are often the victims. It is for this reason that legislation is sorely needed to reform our nation's civil justice system. There are many bills pending before Congress that would take positive steps forward in stemming the tide of lawsuit abuse. However, one bill – H.R. 4571, recently introduced by Representative Lamar Smith, stands out, in my opinion, as particularly helpful in curbing, if not stopping, many of the types of suits I have described.

H.R. 4571 would put teeth back into Rule 11. Rule 11 sets forth requirements that attorneys must meet when bringing a lawsuit and *permits* judges to sanction attorneys if they do not meet those conditions. Specifically, Rule 11 requires every pleading to be signed by at least one attorney.[13] It also states that when an attorney files a pleading, motion, or other paper with a court he or she is "certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances [that:]

(1) it is not being presented for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
(2) the claims, defenses, . . . are warranted by existing law or by a nonfrivolous argument for [a change] of existing law or the establishment of new law;
(3) the allegations and other factual contentions have evidentiary support or, . . . are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
(4) the denials of factual contentions are warranted on the evidence or, . . . are reasonably based on a lack of information or belief."[14]

Importantly, it also provides attorneys with a 21-day window to withdraw a frivolous lawsuit after opposing counsel provides notice of intent to file a motion for sanctions. This is commonly referred to as Rule 11's "safe harbor" provision.[15]

Rule 11, in its current form, is the product of revisions made in 1993. These revisions rendered it nothing more than a "toothless tiger." As a result, unscrupulous attorneys, out to make a quick buck, know that the odds of being sanctioned under Rule 11 are remote. The 21-day "safe harbor" provision, in particular, provides an easy way for plaintiffs' attorneys to avoid sanctions by simply withdrawing a lawsuit. Unscrupulous attorneys receive something more like a "get out of jail free" card when they bring frivolous lawsuits.

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13 Fed. R. Civ. P. 11(a).
14 *Id*. at 11(b).
15 *Id*. at 11(c)(1)(A).

H.R. 4571 would remedy this and other problems by:

(1) Making Rule 11 sanctions mandatory when an attorney or other party files a lawsuit before making a reasonable inquiry;
(2) Eliminating the "safe harbor" provision;
(3) Allowing for Rule 11 sanctions to be filed during discovery; and
(4) Permitting monetary expenses, including attorneys' fees and compensatory costs, against a represented party.

The legislation also would extend these protections to state cases that affect interstate commerce and curb forum shopping by only permitting the plaintiff to sue where he or she lives, was injured or in the location of the defendant's principal place of business.

Conclusion

Frivolous lawsuits are hurting small-business owners, new business formation, and job creation. The growing number and costs of lawsuits, particularly those not based in fact, threaten to stifle significantly the growth of our nation's economy by hurting a very important segment of that economy, America's small businesses. We must work together to find and implement solutions that will stop this wasteful trend. On behalf of America's small-business owners, I thank this Committee for holding this hearing and providing us with a forum to tell our story.

We are hopeful that through your deliberations you can strike the appropriate balance to protect those who are truly harmed and the many unreported victims of our nation's civil justice system – America's small businesses.

Thank you.